



Alliance of Western Milk Producers

Representing California's dairy cooperatives and their producer-owners since 1991

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December 14, 2006

Mr. Dave Ikari
Dairy Marketing Branch
California Department of Food & Agriculture
1220 N Street
Sacramento, CA 95814

Subject: Post hearing brief on Class 1 hearing held December 5, 2006

Dear Mr. Ikari:

The Alliance of Western Milk Producers appreciates the opportunity to submit this post-hearing brief. Rather than reiterate and reinforce the points made in our direct testimony, this post-hearing brief will respond to issues raised at the hearing by other witnesses.

The members of the Alliance strongly oppose the Dairy Institute's proposal to lower producer Class 1 prices. As stated in their direct testimony, this is, in fact the primary objective of their proposal. That is why the Institute proposes lowering the Class 1 formula adjustment factor from +46.4 cents to minus 17 cents.

As justification, the Institute once again puts forward its implied Class 1 differential theory, stating that the California implied Class 1 differential is higher than it would be if California were in a federal order. They stated that the California Class 1 price differential was 35 cents too high. The Institute arrives at this number by subtracting its implied differential (\$2.15) from \$1.80, which is the Institute's estimate of the weighted average differential under federal orders.

The problem is that the federal order differentials are based on a Class 1 differential pricing surface developed by Cornell University from 1995 data. The surface is developed based on the availability of local milk versus the supply available nearby. So, for Los Angeles County it was set at \$2.10 while Tulare County was at \$1.60.

However, the panel should note that the availability of milk close into major California metropolitan areas has dropped significantly. In the last five years the milk available in Riverside and San Bernardino counties has fallen nearly 50% and 25% respectively. Southern California milk production went from 5.5 million pounds in 2001 to 3.9 million in 2005. Urban sprawl has reduced the major milk production area to the South San Joaquin Valley.

Considering the shift in milk production above, the Alliance argues that rather than the implied differential being too high as the Institute asserts, it is in fact too low. Therefore, the Class 1 price should not be lowered as the Institute proposes, but it should in fact be raised as proposed by the Alliance.

The Institute also proposes adding a dry whey factor into the cheese CRP formula including what it calls an adjustment factor and the Alliance considers a manufacturing allowance. The Institute's intent is that this will result in California Class 1 prices "tracking" better with surrounding order Class 1 prices. The simple fact is that when you compare the current Class 1 formula to the Institute's proposal, there is no significant improvement in how prices track, as the chart on page 7 of the Alliance's testimony clearly shows. The charts on page 8 of the Dairy Institute's testimony created setting the California Class 1 prices at zero don't show any appreciable improvement in price relationships and provide no quantitative measure of how much better their proposal tracks federal order Class 1 prices.

The major flaw of all proposals for adding a dry whey factor with a make allowance into the cheese CRP formula is that it can result in a reduction in the cheese CRP not related to the primary commodity value – cheese. In the Dairy Institute's approach, this will occur when the dry whey price falls below 15 cents. This occurred six times in the 13 months from July 2002 through July 2003. MPC's proposal has a negative impact on the cheese CRP when the whey price falls below 17 cents which has occurred 11 times in the 15 months from June 2002 through August 2003.

In supporting the concept of a dry whey factor in the cheese CRP formula, MPC states that one of its concerns is that when whey prices fall California's market will again become attractive to Arizona milk. This raises the question: Doesn't adding a whey factor into the cheese CRP raise the California Class 1 price making the market attractive then as well?

Finally, on page 11 of its testimony, the Institute presents a graph comparing the decline in California per capita sales to the decline in U.S. per capita sales. The implication is clear. California's farm milk prices have had a negative impact on sales. Two sets of facts show how wrong the implication is. One is the retail price data comparison. Retail prices in California are consistently higher than retail prices in contiguous states even though farm prices have been significantly lower.

The other is the demographic differences between California and the U.S. in total. In 1980, Hispanics made up 19% of California's population. By 2005, that number rose to over 35%. Asian population rose from 5.3% to 13.5%. So, California went from a population of 24% traditionally non-milk drinkers in 1980 to nearly 49% in 2005. This is an important piece of data. Half the population of California in 2005 are not considered regular milk drinkers. In fact, U.S. Census data indicates that the number of white non-Hispanics in California is virtually unchanged since 1980. Why has milk consumption declined faster in California than in the U.S.? Demographics answer that question very clearly.

Conclusion

The Alliance proposal fulfills the requirements of California law 62062.1. It brings California producer Class 1 milk prices into a more reasonable relationship with the producer Class 1 prices in contiguous states while allowing California processors to remain competitive both in California and outside of California as well.

The Alliance members urge the Department to adopt its proposal and adjust Class 1 prices accordingly.

Respectfully submitted by:

A handwritten signature in black ink that reads "Jim Tillison". The signature is fluid and cursive, with a long horizontal line extending from the end of the name.

James E. Tillison
Acting Executive Vice President/CEO